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The economic situation in the Economic Commission for Europe region: Europe, North America and the Commonwealth of Independent States in 2010-2011

Summary

Of the five United Nations regions as defined by the regional commissions, the Economic Commission for Europe (ECE) region was the most negatively impacted by the recent financial and economic crisis. Real growth for the region declined from 3.2 per cent in 2007 to 0.9 per cent in 2008 to minus 3.7 per cent in 2009 and recovered to 2.6 per cent in 2010. However, 9 or about one sixth of the region's economies continued to experience negative growth in 2010. The current forecast is for growth of 2.8 per cent in 2011 and 2012. Owing to the crisis, sovereign debt levels have increased significantly in a number of the region's economies and have become problematic; this has led to premature fiscal consolidation that has delayed and weakened the recovery. In many economies (except in North America), gross domestic product (GDP) remains below pre-crisis levels.

Unemployment remains high in most of the advanced economies in the region and inflation is beginning to exceed central bank targets.

The ECE region has accounted for more than one half of world economic output (on a purchasing power parity basis) for over a century. However, its share of world GDP has recently fallen below 50 per cent owing to the more rapid growth in the developing economies. As recently as 2000, countries of the European Union and North America each accounted for more than a quarter of world output and the European emerging economies of East and South-East Europe, the Caucasus, and Central Asia accounted for another 5 per cent. The world share of the European Union and North America has now declined to just over one fifth each while that of the European emerging economies has increased to 6 per cent. The share of the ECE region in world output is expected to continue to decline in the coming decade as its growth in population and per capita income are both below world averages.

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I. The Economic Commission for Europe region in global perspective

1. The ECE region, composed of 56 member States, remains quite diverse. Although it contains most of the world's advanced economies, 26 (or almost one half) of its member States have a per capita income below twice the world average, while 12 of these are below the world average and 5 of these are below one half of the world average. Nine of its economies are considered as United Nations landlocked developing countries.

2. In the first two decades after the Second World War, the countries of Western Europe and the Soviet Union grew faster than the United States and there was therefore some convergence in the per capita incomes of these regions. By the early 1970s Western Europe had a per capita income of approximately 70 per cent of that of the United States, while the Soviet Union had a per capita income of about 35 per cent of the United States, or one half of Western Europe. However, since 1972 there has been no further convergence between Western Europe and the United States while the average income of the States of the former Soviet Union has declined to only one fourth of that of the United States and one third of that of Western Europe. Therefore, over the last 40 years there has been no convergence, but in fact some additional divergence, in the living standards of the three major geographical subregions of the ECE.

3. The ECE economies imported $9.7 trillion and exported $8.9 trillion in 2008; those economies account for 60.6 per cent of world imports and 56.0 per cent of world exports (using 2008 data as 2009 data is distorted by the significant trade declines associated with the global economic crisis). The world shares by major ECE geographical subregion are as follows: North America accounts for 16.1 per cent of imports and 11.1 per cent of exports, Europe (including South-East Europe, Turkey and Israel) accounts for 41.6 per cent of imports and 40.4 per cent of exports, and the Commonwealth of Independent States plus Georgia accounts for 2.9 per cent of imports and 4.5 per cent of exports.

4. Over the last three decades, growth in the advanced ECE economies has been relatively slow compared to other world regions and to their own post-World War II historical experience. In many of these economies, income and wealth inequality have increased; in particular, the income of the very rich has grown significantly above the average. Thus, the economic models of these economies have experienced difficulty in producing strong economic growth while maintaining or increasing the degree of equity. Nevertheless, in many of the Western European economies, especially those in Scandinavia, the levels of income and equity are among the highest in the world.

5. The general increase in income inequality in the ECE economies has been accompanied by a general increase in regional inequality within countries. The crisis appears to have further increased regional variations in income; for example in the United States between 2007 and 2009 income rose in several states but declined by over 10 per cent in two — Michigan and Nevada. Similar trends have developed in many of the ECE economies. In the European emerging economies significant regional variation exists in income levels as well as more general measures, such as in human development indexes; for example between the urban, especially the capital cities, and the rural provinces and in Ukraine between east and west. A

notable exception to this longer-run trend of greater regional inequality has been the convergence in incomes between the western and eastern regions of Germany and between northern and southern Italy.

6. An important consideration in evaluating national economic policy is the degree to which the country's national income is successfully used to promote the economic welfare of its population. Economic welfare remains a normative concept but the most important factor in determining its level is generally believed to be that of per capita national income. Additional considerations include a high degree of income, gender and ethnic equality, and high levels of education, leisure and health care (including life expectancy). Numerous attempts have been made to quantify economic welfare including that of the UNDP Human Development Index. Generally, these studies have concluded that the high-income advanced economies of the ECE region, especially the Scandinavian economies, have achieved the highest levels of economic welfare. After controlling for the level of per capita income, the European Union new member States and the European emerging economies are generally found to have high levels of economic welfare. However, somewhat paradoxically, surveys asking residents to rate their own happiness find that the European emerging economies do poorly after controlling for their level of per capita income.

7. The advanced ECE economies are the main global sources of outward foreign direct investment (FDI). The ECE economies accounted for almost $1.5 trillion in FDI outflows or over 76 per cent of the world's total FDI outflows in 2008. In 2009, total ECE FDI outflows declined by almost half to $780 billion. Of the world's top 20 sources of FDI, 15 are ECE economies. The United States is the largest source of FDI in the world, followed by France. In addition, the Russian Federation is a major source of outward FDI; in terms of both recent annual flows and in the level of FDI stocks, Russian outward FDI is similar in size to that of China. The ECE economies were the destination for almost $1.1 trillion of FDI inflows in 2008; this represented over 61 per cent of world FDI inflows. The United States is the largest recipient of FDI inflows in the world; Russia is the second largest emerging economy recipient after China. Overall, the UNECE region is a net investor (i.e., outflows exceed inflows) of FDI and in 2008 supplied approximately $400 billion of net FDI to the rest of the world. However, the European emerging economies are a net recipient of FDI (i.e., inflows exceed outflows) with their inward FDI stock almost twice the level of their outward stock.

II. The economic and financial crisis in the Economic Commission for Europe region

8. World GDP (on a purchasing power parity basis) declined by 0.8 per cent in 2009; the advanced economies (North America, Western Europe and Japan) were particularly negatively affected, although significant parts of the developing/emerging world (especially in Asia) largely avoided the worst of the crisis and were able to maintain reasonable although lowered economic growth. However, that was not the case for the European emerging economies and the new member States of the European Union, which were the most negatively impacted regions in the world.

9. Of the three subregions of the ECE (Western and Central Europe — including all of the European Union, North America and the European emerging economies),

the decline in GDP growth was the largest in the European emerging economies both in terms of its actual level in 2009, which was -6.2 per cent, and in terms of the decline relative to recent historical experience; the growth rate in 2009 was 13.8 percentage points less than the five-year average of 2003 to 2007. Western and Central Europe had a growth rate of -4.0 per cent in 2009, which represented a change of -6.6 percentage points from 2003-2007. North America was the least impacted ECE subregion with growth of -2.6 per cent in 2009, which represented a decline of 5.4 percentage points from the 2003-2007 average. Despite the fact that the emerging economies were the most severely affected subregion, eight of the economies had positive growth in 2009; Poland and Israel were the only remaining economies in the rest of the ECE to have positive growth in 2009.

10. Despite the severity of the financial shock, the aggressive use of monetary and fiscal policy, a relatively high level of economic cooperation among the Governments of the countries of the region, and assistance from international and regional financial institutions allowed the crisis to be contained. Without those unprecedented and quite extraordinary policy responses, in all likelihood, the region would have experienced another depression similar to the 1930s. The well-developed social safety nets of the region acted as automatic stabilizers and that further helped to maintain national income as well as limit the human and social costs of the crisis.

11. During the crisis, the United States implemented more aggressive monetary and fiscal expansions than the European countries; it lowered interest rates further and faster and its fiscal deficit was larger. There were numerous reasons for that but importantly, it was due to the fact that the social implications of high unemployment are greater in the United States than in Western Europe. The duration of unemployment insurance in the United States is shorter (often only 6 months although there were some extensions during the Great Recession) and since medical insurance is usually job-based, unemployed United States workers are vulnerable to losing their access to medical care. Given the higher social costs of unemployment in the United States, it puts greater emphasis on counter-cyclical macroeconomic policies.

12. Despite the ongoing recovery, this crisis will have significant long-term implications for living standards in much of the world and in the design and operation of domestic, regional and international institutions. Generally the crisis has reduced the influence of the ECE economies in global governance; for example, the G-20 has effectively replaced the G-7 as the main global body for promoting macroeconomic coordination and International Monetary Fund (IMF) board seats and quotas allocated to European countries have been slightly reduced. At the regional level, the crisis has resulted in significant institutional change within the European Union.

13. Although the new member States and the European emerging economies experienced a very serious crisis in 2009 with some large GDP declines, that crisis was not even close to the severity of the economic decline experienced in the 1990s during the transition from planned to market economies. All but a few of those economies will have higher real GDP by early 2012 than prior to the crisis in 2008 while many of them needed over 15 years to get back to their 1989 pre-liberalization levels during the transition crisis. However, the Russian Federation and many of the

Commonwealth of Independent States economies were more negatively impacted by the recent crisis than by the 1998 Russian currency crisis and sovereign default.

14. The severity of the crisis in the new member States and the European emerging economies was due to a number of significant vulnerabilities that had developed in many of them. They included extremely large current-account deficits, large amounts of short-term external debt (i.e., bank loans), rapid credit growth, which was especially problematic given that banks had quite limited credit histories for many of their borrowers, a high share of foreign-currency denominated loans, fixed exchange rates in some, and housing and asset bubbles. The one fundamental vulnerability often associated with a crisis which those economies did not have was either a large fiscal deficit or a high level of sovereign debt. In order to promote future financial stability, current economic policy should ensure that those vulnerabilities do not reappear as the recovery proceeds.

15. A number of ECE economies benefited enormously from external assistance provided by numerous multilateral organizations including the IMF, the European Bank for Reconstruction and Development (EBRD), and the European Union. As is generally the case, that assistance was contingent on the countries agreeing to implement certain policies or achieving certain targets. The IMF having received considerable criticism for the severity of its conditionality for the Asian economies during the 1998 crisis relaxed considerably its conditionality during the crisis. Nevertheless its policies generally required some tightening of the existing macroeconomic policy of the recipient country. Many of the programmes, especially those for the new member States were designed and financed jointly with the European Union. Generally it seems that the European Union pushed for stronger conditionality than the IMF in those joint programmes. During the crisis, 16 of the region's economies were forced to turn to the IMF for some form of assistance; that included several countries from each of the subregions, including 3 advanced economies, 4 of the new member States, 7 in the Commonwealth of Independent States and 2 in South-East Europe.

16. There was significant concern during the 2008/2009 crisis about the fact that the banking systems in many of the European Union new member States and South-East Europe had a high level of foreign ownership. There was the potential that the bank parents could have drained liquidity out of these economies to store up their parent operations. However, overall, that did not happen and it has now been concluded that foreign ownership generally proved to be a stabilizing influence. To some degree, that was due to the assistance those financial systems received from the IMF, EBRD, the World Bank, and the European Investment Bank under the Vienna Initiative. Nevertheless, foreign ownership does pose a possible systemic risk as has happened again in South-East Europe with the Greek debt crisis (as Greek banks have a market share of about 20 per cent in South-East Europe); thus, how to obtain the maximum benefit from international financial integration, while cross-border financial regulation remains limited, remains a challenge for policymakers.

17. Despite the severe economic downturn during this crisis, political and social stability were generally maintained throughout the region, although there were numerous demonstrations and some public disturbances in some of the most impacted economies. Therefore, the situation was considerably different from what developed in the 1930s. That was due importantly to the well-developed social

safety nets that have been created in those economies and the fact that Governments were able to contain the economic declines by aggressively using macroeconomic counter-cyclical policies.

18. Although there were a variety of underlying causes of the recent financial and economic crisis, a central factor was that the financial authorities in ECE advanced economies failed to properly regulate their financial industries. In the aftermath of the crisis, extensive regulatory changes have been implemented that should reduce the likelihood of a similar crisis in the future. However, in many cases the strongest or most extensive proposals were often times not implemented over concerns about how they might impact the competitiveness of a country's financial sector. A higher degree of regulatory harmonization achieved through better international cooperation could have reduced those concerns and produced a more stable financial sector.

19. The financial crisis highlighted several deficiencies in the institutional design of the European Union and in particular in the design of the eurozone. At the most general level, economic coordination among its members proved inadequate for crisis management. A centralized fiscal authority plays a central role in maintaining internal equilibrium in a currency union but that does not exist in the eurozone. Having a central bank that can act as lender of last resort can be a stabilizing influence during crisis periods; however, the European Central Bank is not authorized to carry out that function. The underlying logic in the design of the eurozone was that internal imbalances would primarily result from mismanaged public accounts but the crisis has demonstrated that the private sector can often create large imbalances even when government finances are prudent. In addition, the eurozone has no mechanism for correcting internal current-account imbalances other than deflation in deficit economies; this is a process that usually leads to long periods of high unemployment and can therefore be quite costly. Additional issues, such as how to achieve financial market integration while financial market regulation remained essentially national raised some fundamental issues about how the European Union was or should be designed.

III. The current economic situation

20. The moderate recovery of the ECE region in 2010 and 2011 is forecast to continue into 2012 and no widespread double-dip recession is expected. Nevertheless, many of the economies of the region will not return to their pre-crisis income level peaks (generally in 2008) until 2012. The economic recovery for the region will be moderate owing to the effects that unemployment will have on constraining consumer expenditures, the need for Governments to withdraw fiscal stimuli prematurely because of rapidly increasing debt levels, and owing to the fact that the financial systems in those economies remain partially impaired as they recapitalize and de-leverage. In several economies that experienced housing busts, the housing and construction sectors continue to act as a drag on the recovery. Growth for the European emerging economies is likely to be stronger than in the ECE advanced economies but they are bouncing back from steeper declines; the outlook for those economies is especially sensitive to global economic developments. Overall, that region will continue to experience growth rates in the coming years considerably below the world average as well as its own average in the five years prior to the crisis.

21. During the crisis, unemployment rose in most of the ECE economies throughout 2009 but stabilized in the early part of 2010; in the United States and the European Union the rate peaked at slightly over 10 per cent while it was close to, but slightly below, that in the largest emerging economies. However, unemployment exceeded 15 per cent in Estonia, Georgia, Latvia, Serbia, and Spain and 30 per cent in Bosnia and Herzegovina and the former Yugoslav Republic of Macedonia. The forecast is that unemployment rates in most of the ECE countries will remain significantly above trend for another three to four years. The human costs of those high levels of unemployment will further increase as unemployment insurance is exhausted and as households deplete their savings.

22. Given the declines in GDP that did occur, the declines in employment were greater than what would be expected in the United States and smaller than expected in Western Europe. Thus, although the decline in GDP was lower in the United States than in the eurozone, unemployment increased more in the former. That was due largely to the differences in labour market flexibility between the subregions. However, some European countries such as Germany, Italy and the Netherlands implemented a number of emergency or short-term labour market policies whose intent was to minimize job losses and a number of them proved to be quite successful. For instance, Germany experienced little change in unemployment as the rate in the spring of 2010 was similar to the rate two years earlier. The increase in unemployment in the Russian Federation was also quite small given the large decline in GDP.

23. In most countries of Europe and Central Asia the unemployment rates are two to three times higher for youths than for adults. That reflects the limited work experience of young job seekers and their greater vulnerability to economic downturns. Youth unemployment rates vary inversely with the level of education and particularly school leavers without work experience have low chances of finding jobs. The low level of educational attainment explains to some extent why unemployment of young job seekers from disadvantaged backgrounds is particularly high. Moreover, the fragile labour market position of youth reflects growing mismatches between their skills and those sought by employers. The recent crisis has further aggravated the situation of youth employment since employers have sharply cut recruitment of school leavers. The unemployment rate for minorities and certain ethnic groups are especially high; for example, in the United States the unemployment rate for black teens is 45.4 per cent. More generally, high youth unemployment presents a threat to social cohesion in a number of ECE mature and emerging economies.

24. Governments in Europe and Central Asia have responded to the economic crisis with various measures that seek to reduce unemployment. Such measures were aimed mainly at the preservation of existing jobs rather than the creation of new ones. However, some countries have also targeted the employment of young people with the aid of subsidized apprenticeship and internship programmes as well as wage subsidies or social tax reductions for new entrants. Nevertheless, very high levels of youth unemployment are likely to persist in a number of ECE countries for the next two to three years.

25. The recovery in the United States has been quite moderate owing to the drag from the housing sector. Sales of new homes early in 2011 were the lowest on record since statistics began in 1963 and significantly below the already depressed

levels in 2010. House prices have continued to decline and have now fallen more since their peak in 2006 than they fell during the Great Depression in the 1930s; inventories continue to rise as a result of foreclosures totalling about 600,000 a month. It is estimated that the wealth effects from the 30 per cent decline in United States house prices have depressed consumer expenditures on the order of $240 billion a year.

26. Core inflation in many of the ECE advanced economies and many of the new member States generally remains below central bank targets of about 2 per cent due to economic weakness. However, headline consumer prices in the eurozone and the United Kingdom have recently been increasing and for some time have been over their central bank targets. Concerns about the potential for further inflation have been accumulating owing to the rapid growth of central bank liquidity and rising global commodity prices. As a result the central banks in the eurozone and the United Kingdom are likely to gradually increase interest rates in the second half of 2011. The United States Federal Reserve is likely to withhold interest rate increases until there is more evidence that the core rate is increasing or that inflationary expectations are affecting wage demands. Inflation rates in the European emerging economies are generally in the higher single digits; those rates are more typical for those economies and represent to some degree their current and expected faster economic growth. In addition, the higher global commodity prices are likely to have a greater impact on inflation in the emerging economies since food prices represent a much higher percentage of their consumption expenditures.

27. Real trade (in volume terms) declined throughout the ECE region in 2009 compared to 2008 levels owing to the economic crisis. North American exports declined by 15 per cent while imports declined by 17 per cent; European exports and imports both declined by 15 per cent; Commonwealth of Independent States exports declined by 5 per cent while imports declined by 26 per cent. Although the real decline in Commonwealth of Independent States exports was relatively small, the nominal decline was quite large owing to the collapse in oil prices. Thus for example, Russian exports declined by 39 per cent in dollar terms in 2009. During 2010 trade rebounded but for many of the ECE economies had yet to get back to pre-crisis levels by the end of the third quarter of 2010; extra-European Union exports have grown much faster than intra-European Union exports owing to the economic weakness in that region.

28. The fiscal budget and debt situation of the advanced economies of the region has deteriorated considerably and in some cases has become problematic owing to the discretionary stimulus measures implemented but more importantly to the automatic stabilizers which resulted in declining tax revenues and increases in mandated income support measures. In some cases Governments felt obliged to assume the debts of their private financial sectors in order to stabilize their financial markets. Sovereign debt levels have become particularly worrisome, since the crisis-related debt has been added on to the already projected long-term fiscal deterioration due to demographic developments, unless there are significant changes in pension and tax policies. Significant market uncertainty exists as to whether the sovereign debt levels in some of the most severely impacted eurozone economies represent just a liquidity problem or a more serious solvency problem.

29. The sovereign deficit/debt situation of several eurozone periphery economies, including Greece, Ireland and Portugal and possibly Spain, Italy and Belgium has

become problematic. Interest rates on sovereign debt have become relatively high and have therefore raised concerns as to whether the affected countries will be able to fully service their debts. The European Union has responded by creating several facilities to aid economies facing financing difficulties. A support package of €110 billion was designed and provided to Greece. A more general facility available to any eurozone economy was established (worth about €750 billion) which provided assistance to Ireland and Portugal in the first half of 2011. This temporary facility will be made permanent in 2013 and named the European Stability Mechanism (ESM). All this assistance has been designed and implemented with the assistance and funding of the IMF. Countries receiving funds are subject to conditionality regarding macroeconomic variables and more generally, the eurozone has implemented more stringent ongoing macroeconomic requirements in order to maintain each country's competitiveness within the eurozone.

30. Global imbalances are considered to be one of the root causes of the economic crisis. The United States current-account deficit exceeded 6 per cent of GDP during 2006 but declined to 3 per cent of GDP at the end of 2009 and remained at only 3.4 per cent of GDP in mid-2011. The uneven recovery whereby the developing economies, including especially China, grew much faster during 2009-2011 than the United States had the desirable effect of keeping global imbalances from returning to their levels prior to the crisis. However, once a global recovery is fully achieved, it is likely that imbalances, and the vulnerabilities they create, will return to undesirable and unsustainable levels if not properly addressed with exchange rate adjustments. Imbalances are also a major problem within the eurozone and the inability to adjust exchange rates are making a resolution of that problem particularly difficult.

31. A significant vulnerability for many of the non-resource-rich European emerging economies prior to the crisis were large current-account deficits due to the dependence of these economies on foreign savings to finance their development. The current-account deficits narrowed quite significantly and rapidly once the crisis hit. The average current-account deficit for the new member States declined from approximately 12 per cent of GDP in 2007 to roughly nil in 2009. The adjustment in the current-account deficits of the Baltic economies has been exceptionally large. The current-account deficits in the new member States and South-East Europe are forecast to remain reasonably low and would therefore appear to be sustainable. That is due to the expectation that capital inflows to those regions will be considerably smaller in the future than they were before the crisis. As a result, it will require a structural change in their underlying growth models from an emphasis on externally financed consumption and investment to domestically financed export production. However, by mid-2011 several European emerging economies, including Turkey and Belarus, had developed large current-account deficits which were becoming problematic. The resource-rich Commonwealth of Independent States economies had large current-account surpluses prior to the crisis; they averaged 15 per cent of GDP in 2008. During the crisis those surpluses declined to only 3 per cent of GDP in 2009. As world growth has picked up, the surpluses have begun to increase again and the IMF forecasts that by 2013 they may average about 10 per cent of GDP, which was their level in 2006.

32. For a number of the European emerging economies, remittances are a very significant component of gross national income (GNI). In 2009 remittances were officially reported greater than 10 per cent of GDP for Albania (10.9 per cent of

GDP), Bosnia and Herzegovina (12.7 per cent), Moldova (23.1 per cent) and Tajikistan (35.1 per cent); other estimates for years prior to the crisis have generally found that remittances were above 10 per cent of GDP in a number of other ECE economies, including Armenia, Georgia, Kyrgyzstan and Uzbekistan. For some of those economies, remittances represent a larger financial inflow than either private capital flows or foreign assistance. In the Commonwealth of Independent States, 31 million people have emigrated to work in another country. Remittances, especially from the Russian Federation, fell by over 30 per cent (or 39 per cent from trend) during the peak of the crisis and were a major channel by which the crisis spread to some of the other Commonwealth of Independent States countries. In 2009 remittances shrank by 36 per cent in Moldova, 28 per cent in Kyrgyzstan and 31 per cent in Tajikistan. Remittances modestly rebounded in 2010 but remained well below 2008 levels. Remittances are far less important, but still significant for many of the new member States.

IV. Progress in achieving the Millennium Development Goals

33. Although significant progress has been made towards achieving the Millennium Development Goals at the global level, the economic crisis has set back progress in some countries for some of the targets. As a result the developing countries remain especially dependent on official development assistance (ODA) from the advanced economies to get back on track. The ECE economies account for 89.4 per cent of total Development Assistance Committee (DAC) net ODA and it is therefore their ability to maintain or increase assistance over the next several years that will be critical. The ODA to gross national income (ODA/GNI) target for 2010 of .34 committed to at the Gleneagles G8 meeting and at the United Nations Millennium +5 Summit was not achieved for a number of reasons, including most likely the economic crisis. Particularly important in the failure to achieve the target was the failure by the European Union to achieve its ODA target of .59 of GNI; it provided only .48. Despite missing its ambitious target, however, the European Union still provides a higher percentage of its GNI than the non-European Union members (except Norway).

34. Within the ECE region, progress in achieving the Millennium Development Goals in the European emerging economies and the new member States has been mixed. Given the large economic declines associated with the transition from planned to market economies, there were significant declines in many of the Millennium Development Goal indicators during the 1990s. Although more recent progress had been strong, even prior to the crisis in early 2008 not all the European emerging economies were on track to achieve all the Millennium Development Goal targets by 2015. With the severe downturn resulting from the 2007-2010 economic crisis, progress has been derailed. Achievement of the Millennium Development Goals is most problematic in the Commonwealth of Independent States, and most likely in the new member States with South-East Europe in between. Overall, progress has been weakest for the health and environmental indicators.

35. Many of the Millennium Development Goal targets have not been achieved in the ECE economies owing primarily to the fact that the targets have not been achieved for specific disadvantaged groups including certain ethnic communities and geographical subregions. Thus, progress in achieving those objectives could benefit especially from more-focused targeting of the specific vulnerable groups. That is

especially true for the Roma in some of the new member States and South-East European economies, whose relative plight in terms of employment and education outcomes have deteriorated since the transition to market economies. Integration of this group requires increased public support for housing, education and health and better implementation of anti-discrimination employment policies. Increasing their employment in the formal sector would increase tax revenues and social security contributions and as a result increased assistance could be largely self-financing.

36. Across the ECE region, women tend to have lower economic activity rates than men, are concentrated in fewer occupations, work fewer hours in paid employment (because of the higher prevalence of part-time working) and have more career interruptions, owing largely to care responsibilities. The adult employment-to-population ratio (aged 25 and above) in 2008 in the ECE was 51 per cent for women and 69 per cent for men. Half of all working women in the European Union are concentrated in either education and health (34 per cent) or the wholesale and trade industry (17 per cent) while half of all working men are concentrated in manufacturing (22 per cent), wholesale and retail (14 per cent) and construction (13 per cent). That gender segregation of women and men in the labour market reflects gender stereotypes in education and the prevailing gender roles in society. Educational choices are strongly gender-biased: women represent the large majority (three quarters) of tertiary students in health- and welfare-related subjects but are a minority (one quarter) in engineering, manufacturing and construction. The gender differences not only result in lower national economic output but also raise equity issues as they contribute to lower earnings (gender pay gap) and slower career progressions, which accumulate over a lifetime to lower pensions in old age. One area for which gender parity has been largely achieved in the ECE region is women's completion of schooling; in fact, women have started to outnumber men in tertiary education.

V. Economic integration and competitiveness in the Economic Commission for Europe region

37. Creating more dynamic and competitive economies through technological advancement is a key factor for increasing living standards in the countries of the ECE. Achieving this objective will require improving the educational levels of the population. Education has a significant public goods component and thus requires significant public funding. Public policies to support research and development is also required owing to its public goods nature or the externalities involved; taxes and subsidies may be needed to increase private sector research and development. Given the extensive changes in industrial structure that will be required to deal with climate change in the coming decades, policies to enhance innovation need to be framed within a technological framework that recognizes those climate- and energy-related considerations. The European Union Europe 2020 Strategy for Jobs and Growth appears to address those issues and provides a framework for other economies to consider; however, implementation will be key since the objectives in its previous Lisbon Strategy were largely not achieved.

38. The ECE economies have extensively pursued economic integration both globally and regionally; as a result, their trade-to-GDP ratios have been increasing consistently over the previous two decades. Although this has produced significant

growth in GDP, it has also resulted in the loss of national autonomy in a number of economic areas to the more general forces of "globalization". Global integration has occurred primarily under the trade liberalization rounds under the auspices of the World Trade Organization (WTO); completion of the currently stalled Doha negotiations remains a key stated objective of most of the ECE economies. However, periods of economic stress with high levels of unemployment are not considered conducive for further trade liberalization.

39. Currently, WTO has 153 members, which account for 97 per cent of world trade. However, seven of the Commonwealth of Independent States economies (Azerbaijan, Belarus, Kazakhstan, the Russian Federation, Tajikistan, Turkmenistan, and Uzbekistan) and three of those in South-East Europe (Bosnia and Herzegovina, Montenegro, and Serbia) have yet to gain accession to WTO. That has been a significant factor that has limited the integration of those former transition economies into the world economy. The Russian Federation is the largest ECE emerging economy and the only G-20 country not in WTO. The Russian Federation has concluded agreements that address most of the substantive economic issues for membership and if some remaining largely political issues can be resolved, its accession would appear to be imminent.

40. Within the ECE, regional integration has occurred significantly owing to the creation of preferential trade agreements; all the ECE economies are partners in at least one preferential trade agreement. These include: in Western Europe, the European Union and the European Free Trade Area; in North America, the North America Free Trade Agreement (NAFTA); in South-East Europe, the Central European Free Trade Agreement; and in the Commonwealth of Independent States there are several institutional frameworks; the Eurasian Economic Community and the Economic Cooperation Organization. Within the European emerging economies almost one half of trade is between preferential trade agreement partners (compared to a world average of one third) but in some cases these agreements are poorly implemented. In some cases there is some preferential arrangement between the different regional trade blocs, such as between the European Union and CEFTA, but generally economies in different preferential areas are integrated primarily on a multilateral non-discriminatory basis under the WTO. For example, there is no preferential arrangement between the United States and the European Union.

41. The economies in ECE trade extensively with the other ECE economies. Over 78 per cent or almost four fifths of exports from ECE economies go to another ECE country. This percentage was stable between 2002 and 2008, although it declined slightly to 76 per cent in 2009 owing to the unusual trade developments associated with the financial crisis. During 2008, 82 per cent of the exports of the 17 members of the European Union (the pre-2004 15 members plus Malta and Cyprus) went to another ECE economy; the percentage of exports to the ECE economies for the other subregions were: 94 per cent for the 10 new member States of the European Union, 57 per cent for North America, 94 per cent for South-East Europe, 84 per cent for the Commonwealth of Independent States, and 79 per cent for the remaining ECE economies.

42. As a result of this pattern of preferential trade agreements and the importance of geographical distance in determining trade, trade within the ECE subregions dominates trade between subregions. For example in 2009, 72 per cent of European exports went to other European partners, and 48 per cent of NAFTA (North American

plus Mexico) exports stayed in NAFTA; the Commonwealth of Independent States is somewhat of an exception as only 19 per cent of its exports stay in the Commonwealth of Independent States. Only 7 per cent of European exports go to North America while 18 per cent of North American exports go to Europe. Nevertheless, the European Union and the United States are each other's largest export market. Trade between North America and the Commonwealth of Independent States is quite limited; only 5 per cent of Commonwealth of Independent States exports go to North America while less than 1 per cent of North American exports go to the Commonwealth of Independent States. With United States-Russian bilateral trade, neither economy is a top 10 destination for the other's exports. Only 3 per cent of Europe's exports go to the Commonwealth of Independent States although 53 per cent of Commonwealth of Independent States exports are destined for Europe; the European Union is the largest import source and export destination of the Russian Federation. Also intraregional trade within the Commonwealth of Independent States has been declining in importance; for example, Russian imports from the other countries of the Commonwealth of Independent States has declined from 25.6 per cent of its imports in 2000 to only 13.7 per cent in 2008.

43. Unilateral preference programmes established by the advanced economies for the developing/transition economies are termed a Generalized System of Preference (GSP). Within ECE, the United States, the European Union, Canada, Norway, Switzerland, the Russian Federation and Turkey have such programmes. Except for the Russian Federation and Norwegian programmes, most of the European emerging economies are GSP beneficiaries (or are eligible for even better programmes as with the European Union and its Stabilization and Association Agreements with South-East Europe or its Autonomous Trade Preferences with Moldova). Preferences are provided for only a limited set of goods, generally only one third to one half of products are covered. Although these programmes do not require reciprocity (i.e., tariff concessions by the developing/transition countries), they often do have some criteria that must be satisfied. For example, currently Belarus, Tajikistan and Turkmenistan are not eligible for the United States GSP owing to concerns about intellectual property or labour standards. The European Union withdrew GSP eligibility for Belarus over labour standards.

44. The eurozone increased to 17 members by adding Estonia on 1 January 2011, making it the fifth new member State to join. The remaining seven new member States are obliged to join sooner or later; although currently none of the remaining new member States meet the entry requirements. Some of them have pegged their currencies to the euro for a number of years and would likely benefit from accession as it would likely further reduce interest rates and increase foreign direct investment levels. The new member States with flexible exchange rates (Czech Republic, Hungary, Poland and Romania) benefited from their ability to depreciate as a useful substitute for wage flexibility during the global economic downturn. Longer term, those countries are likely to join the Economic and Monetary Union only after they achieve higher productivity levels and nominal price convergence. The United Kingdom, which is also outside the eurozone, also benefited considerably from its ability to depreciate its currency versus the euro.

45. There are currently five European Union candidate countries, one of which (Iceland) decided to apply for membership in the wake of a massive financial destabilization hitting its relatively small economy in 2008-2009. The remaining candidate countries (Croatia, Montenegro, the former Yugoslav Republic of

Macedonia and Turkey) started their accession process earlier. The remaining South-East European countries (Albania, Bosnia and Herzegovina, and Serbia) continue to pursue European Union membership; currently Albania has a Stabilization and Association Agreement (which generally includes duty-free and quota-free trade for most industrial and agricultural products) whereas Bosnia and Herzegovina and Serbia have more limited Interim Trade Agreements while they wait for the Stabilization and Association Agreement process to be completed.

46. CEFTA has eliminated or reduced significantly tariffs on the goods of the participating countries but does not abolish customs controls at common borders; it has largely eliminated a complex web of bilateral agreements that were confusing and difficult to implement. The Agreement has been signed by Albania, Bosnia and Herzegovina, Croatia, Moldova, Montenegro, Serbia, the former Yugoslav Republic of Macedonia and the United Nations Interim Administration Mission in Kosovo. CEFTA aims to expand trade in goods and services, foster FDI, protect intellectual property rights in accordance with international standards and harmonize competition rules and state aid. It also includes well-developed procedures for dispute settlement. The Agreement conforms to the rules and procedures of WTO and European Union regulations and provides a framework for the contracting Parties to prepare for European Union accession (the founding CEFTA members are now all members of the European Union).

47. Following a number of unsuccessful attempts to establish a customs union on the territory of the Commonwealth of Independent States, three Commonwealth of Independent States countries (Belarus, Kazakhstan and the Russian Federation) finally implemented one by establishing a common customs code in July 2010 and have further committed to remove all customs borders within their territories in July 2011. A key challenge will be to ensure that the Customs Union Commission of the three countries becomes an effective dispute settlement mechanism. In addition to the customs union, the Governments of Belarus, Kazakhstan and the Russian Federation have declared their intent to deepen mutual economic integration by establishing the common economic space in 2012. Those countries have also agreed in principle to harmonize a number of technical, sanitary and phytosanitary standards which will be similar to those of the European Union as the Russian Federation has already harmonized those standards with the European Union.

48. Several of the Commonwealth of Independent States economies have production and export structures excessively concentrated in energy-related products. For example in 2009, fuel products (SITC 3) accounted for 93 per cent of the exports of Azerbaijan, 70 per cent of the exports of Kazakhstan, and 67 per cent of the exports of the Russian Federation. Although production and export of those products have produced substantial revenue for governmental developmental objectives, including infrastructure development, those commodity sectors do not generally produce large numbers of well-paying jobs and have limited beneficial linkages to other sectors. It is a policy objective of most of the economies to diversify into high value-added manufacturing and services although progress to date has been limited.

49. Future growth in many of the ECE economies needs to be more export-led; as a result policy initiatives are needed that can facilitate that adjustment. They include further trade liberalization (along with WTO accession for non-members), improvements in infrastructure, education and skill levels, promotion of domestic innovation, streamlining border-crossing procedures, the computerization,

simplification and harmonization of customs documents and procedures, and improvements in the investment climate. In the European emerging economies, foreign investment that can bring in managerial and technological expertise can be increased by strengthening intellectual property rights. In some of the ECE economies which had large current-account deficits, unit labour costs rose too fast during the boom period prior to the crisis and adjustments are now needed; that can occur through currency depreciation where possible, deflation or increased productivity growth.

50. Economic integration among the countries of the Special Programme for the Economies of Central Asia (SPECA) remains limited owing to a number of institutional and economic factors. Although there are a number of broad regional initiatives, including those administered by the Commonwealth of Independent States, the Eurasian Economic Community, and the Economic Cooperation Organization, trade agreements in the region are generally bilateral, differentiated, and overlapping. That has created a "spaghetti bowl" effect where the entangled trade policy rules are often very complicated, conflicting and confusing, which makes them hard to implement. The regional agreements attempt to link together a varied trade landscape with different levels of liberalization, which varies from the very liberal in Kyrgyzstan to fairly liberal in Azerbaijan, Kazakhstan, and Tajikistan, to quite restrictive in Uzbekistan. Trading opportunities are further limited by inadequate trade finance capacities. In addition, the physical infrastructure developed prior to 1990 was centralized in a hub-and-spoke structure, with most of the SPECA countries being spokes with connections to the hub but not among one another. Projects are gradually being put in place to create connections between these former "spokes" but there is still much work to be done and the lack of adequate physical infrastructure is an additional barrier to intraregional trade.

51. As a result of the above factors, intraregional trade remains limited, representing less than 10 per cent of the total trade of the countries of SPECA. Moreover, state-owned companies continue to generate the bulk of this trade, often under intergovernmental agreements that involve a select range of capital goods and energy resources. That has rendered a situation whereby products that rank high on SPECA countries' exports to the rest of the world are largely excluded from intraregional trade flows. At the same time, exports remain geographically concentrated in a narrow range of countries, namely China, Italy, France, Germany, the Russian Federation, and the United States, which together account for 62 per cent of SPECA countries' total exports of goods.

52. To reverse those trends, the SPECA countries adopted in 2010 a common framework for fostering intraregional trade. The framework seeks to create dynamic synergies between national and regional trade policies, in addition to achieving greater inclusion of SPECA countries in the global economy and the WTO-led Aid-for-Trade initiative. Other than Afghanistan, the other SPECA countries (which are all ECE members) have up to this point been largely excluded from the Aid-for-Trade initiative. To provide for proper follow-up monitoring and support of trade development initiatives, a SPECA Regional Aid-for-Trade Implementation and Monitoring Council was launched. The Council, working closely with the SPECA Project Working Group on Trade, will bring together beneficiary countries, multilateral and bilateral donors and United Nations agencies working on trade issues, to ensure that all regional trade development priorities identified by SPECA countries are adequately supported by projects and funding.

53. Transport costs are especially high in Commonwealth of Independent States countries because they are disadvantaged geographically, being either landlocked, outside the main trade routes, or having a low density of economic activity (as in Central Asia). In addition, they lack modern infrastructure and have fragmented transport markets that prevent economies of scale. Generally, there appears to be a "virtual border" between Central Europe and the Commonwealth of Independent States with transport times and costs per kilometre continuing to rise as one goes further eastward. The average speed of rail transport (which accounts for 90 per cent of Commonwealth of Independent States freight transport) is 60 km/hour in the European Union versus 45 km/hour in the Commonwealth of Independent States, while the differential is even greater for truck transport (70 km/hour in the European Union and only 37.5 km/hour in the Commonwealth of Independent States). The current institutional structure of the transport network in Central Asia is an important source for the higher transport costs; that includes the ownership structure as well as their pricing policies. The relatively low levels of railway labour productivity indicate that there is considerable scope for improvement in a number of the European emerging economies.

54. Improved transport infrastructure is necessary but not sufficient for the European emerging economies to reap greater benefits from trade. Improved trade and transport facilitation within regional entities and at their external borders are equally important. WTO plays a key role in the facilitation of international trade in goods and services and the ECE complements it by administering 57 United Nations legal instruments for the facilitation of international transport and the reduction of trade barriers. Proper implementation of a number of those instruments would help to reduce the currently high trade costs in the Commonwealth of Independent States.

55. Trade in many of the Commonwealth of Independent States countries is hampered by burdensome administrative costs; that includes the large number of documents required for exporting and importing. Most of the Western European countries require about three to five documents to import or export a standardized cargo of goods. However, Azerbaijan requires 14 documents for importing, while Kazakhstan requires 10 for exporting. The World Bank *Doing Business* report ranks countries in terms of the ease of trading based upon the time and difficulty (i.e., number of documents, etc.) in obtaining customs clearances. In its 2009 report, four (Azerbaijan, Kazakhstan, Tajikistan and Uzbekistan) of the 10 most difficult countries in obtaining customs clearance are in the Commonwealth of Independent States. Differences in technical standards also act as technical barriers to trade; the creation of common standards or acceptance of the principle of mutual recognition of the others' standards would contribute to improving export opportunities and lowering the costs of imports. The failure to make more progress is often blamed on special interest groups, poor governance, corruption, or simply the failure of national Governments to focus attention on these issues. Nevertheless, in recent years a number of Governments in Europe and Central Asia were able to reduce significantly the time and cost of trading across borders with the aid of reforms that improved customs procedures. Such countries include a number of European Union member States (Latvia, Lithuania, Portugal, Slovakia, Spain), South-East European countries (Albania, Bosnia and Herzegovina, Croatia, Montenegro, the former Yugoslav Republic of Macedonia) and Commonwealth of Independent States countries (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Ukraine).